

# HOUSE BILL REPORT

## HB 1359

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### As Reported By House Committee On:

Finance

**Title:** An act relating to the administration and collection of the cigarette tax.

**Brief Description:** Affecting the administration and collection of the cigarette tax.

**Sponsors:** Representatives Van Luven and G. Fisher; by request of Department of Revenue.

### Brief History:

#### Committee Activity:

Finance: 3/1/95, 3/3/95 [DP].

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### HOUSE COMMITTEE ON FINANCE

**Majority Report:** Do pass. Signed by 12 members: Representatives B. Thomas, Chairman; Boldt, Vice Chairman; Carrell, Vice Chairman; Morris, Ranking Minority Member; Dickerson, Assistant Ranking Minority Member; Hymes; Mason; Mulliken; Pennington; Schoesler; Sheldon and Van Luven.

**Staff:** Bob Longman (786-7139).

**Background:** Cigarette and tobacco products taxes are added directly to the price of these goods before the sales tax is applied. The current rate for the cigarette tax is 56.5 cents per pack of 20 cigarettes. On July 1, 1995, the rate will increase to 81.5 cents, and to 82.5 cents on July 1, 1996. The rate for tobacco products, other than cigarettes, is 74.9 percent of the wholesale price. There are no future rate increases scheduled for tobacco products.

Revenue from the first 23 cents of the cigarette tax goes to the general fund. The next 8 cents are dedicated to water quality improvement programs through June 30, 2021, and to the general fund thereafter. The next 22.5 cents (40 cents beginning July 1, 1995, and 41 cents beginning July 1, 1996) go to the health services account. The remaining 10.5 cents are dedicated to youth violence prevention and drug enforcement. For tobacco products tax revenues, 48.15 percent goes to the general fund, 10 percent to the health services account, and the remaining 16.75 percent is dedicated to water quality improvement programs through June 30, 2021, and to the general fund thereafter.

The cigarette tax is due from the first person who sells, uses, consumes, handles, possesses or distributes the cigarettes in this state. Payment is made through the purchase of stamps from banks authorized by the Department of Revenue to sell the stamps. Stamps must be affixed to cigarette packages before any sale, use, consumption, handling, possession or distribution. Unstamped cigarettes are subject to seizure as contraband. Selling cigarettes without a required stamp is a gross misdemeanor. Violations of the cigarette tax laws are also subject to penalties of \$10 per pack, \$250 minimum. Cigarette wholesalers and retailers must keep records of cigarette transactions for five years.

Under federal law, the cigarette tax does not apply to cigarettes sold at an outlet on an enrolled Indian tribal member's tribal reservation to an enrolled tribal member for personal consumption. However, sales made by a Native American cigarette outlet to nontribal members are subject to the tax. The Department of Revenue requires tribal vendors to obtain advance approval from the department before bringing unstamped cigarettes into the state for sale to tribal members. Approval is limited to a quantity reasonably related to the probable demand of qualified purchasers in the trade territory of the vendor.

Federal law also prohibits the transportation or possession of unstamped cigarettes in violation of state law. An extended investigation by the federal Bureau of Alcohol, Tobacco, and Firearms resulted in a series of cigarette seizures in Washington in October and November of 1991. Four Indian retailers were charged with transportation and possession of unstamped cigarettes without obtaining advance approval from the department. A federal District Court dismissed the indictments, holding that Washington law does not prohibit an Indian retailer from acquiring cigarettes from an out-of-state source and holding them without stamps, and without Department of Revenue approval, until sold to non-Indians.

**Summary of Bill:** The definition of "stamp" for the cigarette tax is expanded to include stamps which show tax-exempt status. All cigarettes in Washington must bear either a tax stamp or an exempt stamp. A person may import unstamped cigarettes into this state only after notifying the Department of Revenue in advance. Persons transporting unstamped cigarettes into this state must have documentation for shipments in their possession during transport. Unstamped cigarettes must be stamped within a reasonable period after being brought into the state, as provided in rules of the department.

A person who is exempt from cigarette tax, such as an Indian retailer, is nonetheless subject to a "precollection obligation." Under this obligation, the exempt person must prepay the cigarette tax to the state for cigarettes that the person intends to sell to non-exempt persons. The prepayment must be made at the time tax would ordinarily be due if the cigarettes were possessed by a non-exempt person.

The records kept by cigarette wholesalers and retailers for five years must include physical inventories of cigarettes.

A wholesaler selling to a retailer who does not possess a current cigarette retailer's license is guilty of a gross misdemeanor. Penalties for violation of cigarette tax laws are classified as remedial rather than punitive. The time period for paying cigarette tax assessments and penalties is increased from 10 days to 30 days.

Cigarettes that are given away for advertising or other purposes are not required to have stamps. Instead, the manufacturer must pay the tax on a monthly return, in the manner generally applicable to other major state excise taxes. Packages of these cigarettes must be marked "Complimentary, not for sale, all applicable state taxes paid by manufacturer."

When tax increases are enacted that effect existing inventories, the additional taxes must be paid with a return filed with the Department of Revenue by the last day of the month in which the increase becomes effective.

The Department of Revenue is authorized to adopt rules as necessary to enforce the cigarette tax laws.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill contains an emergency clause and takes effect on July 1, 1995.

**Testimony For:** A recent court case prevents the effective collection of the cigarette tax. This bill strengthens the cigarette tax enforcement procedures. The cigarette tax is too high and this encourages people to purchase cigarettes out of state, or at smokeshops. The Department of Revenue's \$40 million loss estimate is too low. The Department of Revenue should be more aggressive in enforcement of cigarette taxes. The bill is a step in the right direction, but will not be enough to stem the flow of contraband cigarettes because the tax is too high.

**Testimony Against:** None.

**Testified:** (Pro) Representative Steve Van Luven, prime sponsor; Paul Jacobsen, and Doug Burke, Washington Wholesale Marketing Association; Carl R. Erickson, Harbor Wholesale Grocery; Steve Frisch and Gary O'Neil, Department of Revenue; and Mark Smith, National Coalition Against Crime and Tobacco Contraband.